federal register

Wednesday
November 7, 1979

Part V

Department of the Interior

Bureau of Land Management

Outer Continental Shelf, Joint Federal/ State Beaufort Sea; OCS Leasing Systems, Sale No. BF

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OUTER CONTINENTAL SHELF, JOINT FEDERAL/STATE BEAUFORT SEA

Notice of Outer Continental Shelf Leasing Systems, Sale No. BF

Sec 8(a)(8) (43 U.S.C.1337(a)(8)) of the Outer Continental Shelf Lands Act, as amended, requires that, at least 30 days before any lease sale, a notice be submitted to the Congress and published in the Federal Register:

(A) identifying the bidding systems to be used and the reasons for such use; and

(B) designating the tracts to be offered under each bidding system and the reasons for such designation.

This notice is published pursuant to these requirements.

A. Bidding systems to be used. In OCS Lease Sale BF, a system employing a cash bonus bid with a royalty established according to a semi-logarithmic sliding scale will be used on all 50 Federal and disputed lease units. This system is authorized by Sec. 8(a)(1)(C) of the OCS Lands Act, as amended. The use of the sliding scale royalty system was first introduced in OCS Lease Sale #43 and used again in the last seven OCS lease sales as part of the commitment by the Department of the Interior and the Department of Energy to develop and test new bidding systems.

The sliding scale is designed to establish higher royalty rates for larger reservoirs with higher production rates. In such cases, the expected bonus would be reduced, which may improve competition for leases. This would also tend to reduce the likelihood of production losses that could result if royalty rates are set by other means, such as royalty bidding, at levels so high that production is made uneconomic. These production losses are dependent upon the different exploration, development and production costs for the specific area. Because the assumed costs were different in the Sale BF area than other areas, the formula provided for this sale is slightly different from that utilized in other sales (for example, Sale No. 42).

The sliding scale used in Sales #43 and #45 was linear in form. Although this form is easy to depict it has three disadvantages which may affect the socially optimal level of production. At certain levels of production, a linear schedule causes erratic fluctuations in the royalty charged on increments in output which may lead producers to make socially non-optimal production decisions in order to minimize these royalty impacts on revenues. Marginal royalty rates also can reach very high levels even though average rates are low. In addition, because production costs are non-linear it can be shown that the royalty rate schedule should more closely conform to the functional form of these costs in order to minimize production losses.

The fixed sliding scale formula operates in the following way: when the quarterly value of production, adjusted for inflation, is less than or equal to $13.236229 million, a royalty of 16.66667 percent in amount or value of production saved, removed or sold will be due on the unadjusted

value or amount of production. When the adjusted quarterly value of production is equal to or greater than $13.236230 million, but less than or equal to $1662.854082 million, the royalty percent due on the unadjusted value is given by the formula

$$Rj = b[Ln\ (Vj/S)]$$

where

Rj = the percent royalty that is due and payable on the unadjusted amount or value of all production saved, removed or sold in quarter j

b = 10.0

Ln = natural logarithm

Vj = the value of production in quarter j, adjusted for inflation, in millions of dollars

S = 2.5

When the adjusted quarterly value of production is equal to or greater than $1662.854083 million, a royalty of 65.00000 percent in amount or value of production saved, removed or sold will be due on the unadjusted quarterly value of production. Thus, in no instance will the quarterly royalty due exceed 65.00000 percent in amount or value of quarterly production saved, removed or sold.

In adjusting the quarterly value of production for use in calculating the percent royalty due on production during the quarter, the actual value of production will be adjusted to account for the effects of inflation by dividing the actual value of production by the following inflation adjustment factor. The inflation adjustment factor used will be the ratio of the GNP fixed weighted price index for the calendar quarter preceding the quarter of production to the value of that index for the quarter preceding the issuance of the lease. The GNP fixed weighted price index is published monthly in the Survey of Current Business by the Bureau of Economic Analysis, U.S. Department of Commerce. The percent royalty will be due and payable on the actual amount or value of production saved, removed, or sold as determined pursuant to 30 CFR 250.64 and Sec. 6(b) of the lease form.

Note that the effective quarterly royalty rate depends upon the inflation adjusted quarterly value of production. However, this rate is applied to the unadjusted quarterly value of production to determine the royalty payments due.

B. Designation of Tracts. The joint nature of the lease sale as between the Federal Government and the State of Alaska made it desirable to offer all the Federal and disputed lease units under the same system. This reduces administrative costs and lessens the complexity of the terms and conditions for potential bidders. Additionally, it facilitates unitization agreements and may prevent inefficient production decisions in order to minimize royalty payments.

Ed Hastey,
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Approved: November 2, 1979.

Heather L. Ross,
Deputy Assistant Secretary of the Interior.

[FR Doc. 79-34457 Filed 11-6-79; 8:45 am]
BILLING CODE 4310-84-C